

State of Montana
Office of the Legislative Auditor

REPORT TO THE LEGISLATURE

OFFICE OF THE STATE AUDITOR

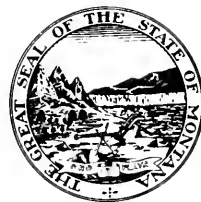
Financial-Compliance Audit for the
Two Fiscal Years Ended June 30, 1988

This report contains ten recommendations for improvement of the office's operations. Major issues addressed in the report include:

- ▶ Retirement Accruals
- ▶ Revenue Classification
- ▶ Investment Requirements

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FINANCIAL-COMPLIANCE AUDITS

Financial-compliance audits are conducted by the Office of the Legislative Auditor to determine if an agency's financial operations are properly conducted, the financial reports are presented fairly, and the agency has complied with applicable laws and regulations which could have a significant financial impact. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States General Accounting Office. Financial-compliance audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

The Single Audit Act of 1984 and OMB Circular A-128 require the auditor to issue certain financial, internal control, and compliance reports regarding the state's federal financial assistance programs, including all findings of noncompliance and questioned costs. This individual agency audit report is not intended to comply with the Single Audit Act of 1984 or OMB Circular A-128 and is therefore not intended for distribution to federal grantor agencies. The Office of the Legislative Auditor issues a statewide biennial Single Audit Report which complies with the reporting requirements listed above. The Single Audit Report for the two fiscal years ended June 30, 1987 has been issued. Copies of the Single Audit Report can be obtained by contacting:

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Operations and EDP Audit
JAMES GILLET
Financial-Compliance Audit
JIM PELLEGRINI
Performance Audit

March 1989

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial-compliance audit report on the Office of the State Auditor's financial activity for fiscal years 1986-87 and 1987-88. The office's written response to the audit recommendations is included in the back of the audit report.

We thank the State Auditor and her staff for their cooperation and assistance throughout the audit.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Scott A. Seacat".
Scott A. Seacat
Legislative Auditor

Office of the Legislative Auditor
OFFICE OF THE STATE AUDITOR
Financial-Compliance Audit for the
Two Fiscal Years Ended June 30, 1988

Audit staff involved in this audit were: Laurie Evans, Wayne Kedish, Rich McRae,
and Cindy Susott.

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ELECTIVE AND ADMINISTRATIVE OFFICIALS

STATE AUDITOR'S OFFICE

Andrea "Andy" Bennett	State Auditor, Elected
Tanya Ask	Deputy Insurance Department
Kathy Irigoin	Deputy Securities Department
Terry Lazure	Administrator Central Administration Division
Debbie VanVliet	Administrator Fiscal Control/Management Division
Donna Warner	Administrator State Payroll Division

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SUMMARY OF RECOMMENDATIONS

This listing serves as a means of summarizing the recommendations contained in the report and the audited agency's reply.

Page

Recommendation #1

The State Auditor's Office ensure all revenue is properly classified on its accounting records.

3

Agency Response: Concur. See page 23.

Recommendation #2

The State Auditor's Office implement procedures to record year-end transactions on a timely basis, and in accordance with state policy.

5

Agency Response: Concur. See page 23.

Recommendation #3

The State Auditor's Office:

- A. Obtain budget authority and transfer \$492,156 to the General Fund.

6

Agency Response: Concur. See page 23.

- B. Transfer the cash balances remaining in the insurance and securities regulatory trust accounts at each fiscal year-end in accordance with state law.

6

Agency Response: Concur. See page 23.

Recommendation #4

The State Auditor's Office:

- A. Obtain additional budget authority to pay the remaining \$13,426 owed to the PERD.

6

Agency Response: Concur. See page 24.

- B. Establish procedures to ensure sufficient authority exists to distribute the total amount of firefighters' unified retirement supplemental to PERD when due.

6

Agency Response: Concur. See page 24.

SUMMARY OF RECOMMENDATIONS
(continued)

Page

Recommendation #5

The State Auditor's Office either:

- A. Invest the available cash balances in the insurance and securities regulatory trust accounts in accordance with sections 17-2-122 and 30-10-116, MCA; or 7

Agency Response: Concur. See page 24.

- B. Seek legislation amending the statutes which require separate investment of insurance and securities regulatory trust moneys. 7

Agency Response: Concur. See page 24.

Recommendation #6

The State Auditor's Office update the Office's property records to include all existing fixed assets.

8

Agency Response: Concur. See page 24.

Recommendation #7

The State Auditor's Office:

- A. Obtain additional training on state accounting policies for its accounting staff. 9

Agency Response: Concur. See page 25.

- B. Develop a comprehensive policy and procedures manual. 9

Agency Response: Concur. See page 25.

Recommendation #8

The State Auditor's Office develop a subrecipient monitoring system for federal moneys in accordance with OMB Circular A-128.

10

Agency Response: Concur. See page 25.

SUMMARY OF RECOMMENDATIONS
(continued)

Page

Recommendation #9

The State Auditor's Office:

- A. Work with BOI to determine the dollar amount of interest earnings that should have been distributed to the counties in fiscal years 1986-87 and 1987-88. 11

Agency Response: Concur. See page 26.

- B. Transfer interest earned on federal forest reserve money to the Federal Forest Reserve Account. 11

Agency Response: Concur. See page 26.

- C. Distribute the interest earned on federal forest reserve money to the counties in accordance with state law. 11

Agency Response: Concur. See page 26.

- D. Invest forest reserve money from the time received until distributed. 11

Agency Response: Concur. See page 26.

Recommendation #10

The State Auditor's Office develop a disaster recovery plan and obtain a smoke detection device. 12

Agency Response: Concur. See page 26.

GENERAL

We performed a financial-compliance audit of the Office of the State Auditor (Office) for the fiscal years 1986-87 and 1987-88. The objectives of our audit were to:

1. Determine if the Office complied with applicable laws and regulations.
2. Determine if the Office's financial schedules present fairly the results of operations for the two fiscal years ended June 30, 1988.
3. Make recommendations for the improvement in administrative and accounting controls of the Office.
4. Determine the implementation status of prior audit recommendations.

This report contains ten recommendations to the Office. These recommendations address areas where management, internal control, and compliance with laws and regulations can be improved. Other areas of concern deemed not to have a significant impact on the successful operations of the programs within the Office of the State Auditor are not specifically included in the report, but have been discussed with management.

In accordance with section 5-13-307, MCA, we analyzed and disclosed the cost, if significant, of implementing the recommendations.

BACKGROUND

Article VI of the Montana Constitution establishes the elected Office of the State Auditor with a term of four years. Duties of the State Auditor are assigned by law. The Office is divided into five divisions or departments.

1. The Insurance Department regulates the insurance industry in Montana. Department duties include issuing certificates of authority to insurers wishing to transact business in the state, examining the financial affairs of authorized insurers to determine if the company is solvent, regulating insurance trade practices, requiring all agents to pass written examinations and be licensed before doing business in the state, and regulating insurance rates to ensure the rates are not excessive, inadequate, or discriminatory.
2. The Securities Department is responsible for the administration and enforcement of the Securities Act of Montana. Department duties include registration of securities issuers, salesmen, broker-dealers, investment advisers, and investment adviser representatives. Also the department investigates cases of unregistered securities and fraudulent securities transactions.

3. Central Payroll Division is responsible for maintaining the statewide Payroll/Personnel/Position Control system. The division produces the biweekly payroll checks for all state employees (excluding University System employees), excludes all elected and mandatory deductions from the employee checks, and files required federal and state tax, unemployment, and Workman's Compensation reports.
4. Fiscal Control and Management Division is responsible for all functions related to the State's warrant system. The functions of this division include: issuing and distributing approximately 1.5 million warrants each year; manually processing emergency warrants; processing cancelled, duplicate, and stale dated warrants; and filing and archiving all cashed warrants.
5. Central Administration Division provides the administrative, budgeting, and accounting functions of the Office. This division maintains a computer system that provides a data base for the other divisions, and provides for the deposit of all fees collected by the insurance and securities divisions.

In addition to the above divisions, the Office is responsible for distributing a portion of insurance premium taxes to the Montana Public Employees' Retirement Division and to fire and police departments in qualifying Montana cities and towns.

The Office's expenditures and transfers-out totaled approximately \$17,853,592 and \$10,976,321 in fiscal years 1986-87 and 1987-88, respectively. Total revenues collected by the Office were \$36,868,516 and \$50,889,650 for fiscal year 1986-87 and 1987-88. The Office collected more revenue in fiscal year 1987-88 because the due date for the tax on insurance premiums changed from annual to quarterly. This is a one time revenue increase.

The following report sections discuss issues noted during our audit of the Office.

REVENUE CLASSIFICATION

The State Auditor's Office records the collection of insurance premium taxes as license and permits revenue on its accounting records. State policy defines license and permits revenue as revenue collected from businesses for various rights or privileges granted by the state. For example, insurance companies must pay an annual license to obtain a certificate of authority to sell insurance in Montana. The definition of tax revenue is revenue collected as a forced contribution made to the state to meet public needs. Insurance companies are required by state law to pay a tax of $2 \frac{3}{4}$ percent of net premium income. The collection of insurance premium taxes should be classified as tax revenue to more accurately reflect the nature of the revenue being collected. The misclassified revenue for the audit period is as follows:

Over (Under)
Statement

FISCAL YEAR 1987-88

General Fund

Licenses and Permits Revenue	\$ 31,622,077
Tax Revenue	(31,622,077)

Special Revenue Fund

Licenses and Permits Revenue	6,592,446
Tax Revenue	(6,592,446)

FISCAL YEAR 1986-87

General Fund

Licenses and Permits Revenue	\$ 17,827,085
Tax Revenue	(17,827,085)

Special Revenue Fund

Licenses and Permits Revenue	6,322,660
Tax Revenue	(6,322,660)

An official at the State Auditor's Office said the premium tax has always been classified as license and permits. Office personnel are establishing a tax revenue class and are planning to record future premium tax collections as tax revenue.

RECOMMENDATION #1

We recommend the State Auditor's Office ensure all revenue is properly classified on its accounting records.

STATE LAW AND POLICY ISSUES

State laws as set forth in the Montana Codes Annotated contain provisions that specify duties and responsibilities for state agencies. As part of our financial compliance audits we evaluate an agency's compliance with state laws. Significant issues of non-compliance are included in audit reports.

The Montana Operations Manual and management memos issued by the Department of Administration, Accounting Division, establish guidelines for state agencies in carrying out their management and accounting duties. Individual agency deviations from these guidelines can result in accounting that is not in compliance with state policy.

The following five report recommendations relate to areas where the State Auditor's Office did not comply with specific state laws or state policy. The Office experienced turnover in the accounting administrator and accounting technician positions since the previous audit. Personnel at the Office indicated that they were not aware of or were unfamiliar with state law and policy issues included in this report.

Fiscal Year-End Procedures

State agencies are given instructions for year-end transactions which describe activities that need to be performed before the close of the state's accounting records. The following two issues describe instances where the State Auditor's Office did not follow prescribed year-end procedures.

Retirement Accruals

Each year between April and fiscal year-end, the Public Employees' Retirement Division (PERD) requests a payment from the State Auditor's Office for the state's contribution for various police and firefighters' retirement accounts. Also each year the Office calculates amounts owed to PERD for the volunteer firefighters and calculates amounts owed to cities and towns for fire department relief associations and police departments not participating in retirement systems at PERD.

The total amount owed to PERD and cities and towns should be accrued in accordance with state policy. The Office did not establish expenditure accruals for amounts owed to the various police and firefighter retirement funds during fiscal year 1987-88. As a result expenditures, and the associated liabilities, in the Special Revenue Fund are understated by \$6,565,649.

Uncleared Collections

At fiscal year-end 1987-88, a balance of \$150,644 remained in the State Auditor's Office uncleared collections account. The Office initially records the receipt of money for insurance and securities taxes, licenses, applications, and fees in an uncleared collections account on its accounting records. Insurance and Securities Division employees review the supporting forms that accompany the money and determine where the revenue should be recorded on the accounting system.

According to state policy, the uncleared collection account should have a zero balance at fiscal year-end. This ensures receipts in the uncleared collections account have been distributed so that all revenue is recorded in the proper year and in the

appropriate fund. Because the Office did not clear this account, General Fund revenue is understated by \$124,057 and Special Revenue Fund revenue is understated by \$26,588 for fiscal year 1987-88.

In this and the previous report section, an Office official explained he was unfamiliar with the fiscal year-end process and thought he had more time to input documents. The year-end instructions explain that uncleared collection accounts must be zeroed out and outline the expenditure accrual process. The instructions also include a general year-end cutoff time schedule. To ensure compliance with the year-end instructions, the Office could develop an internal time schedule specifically outlining the individual duties and detailing the dates documents should be input to be sure they correctly process before the close of the year.

RECOMMENDATION #2

We recommend the State Auditor's Office implement procedures to record year-end transactions on a timely basis, and in accordance with state policy.

Transfers to the General Fund

The State Auditor's Office did not transfer the entire cash balance remaining in the Insurance Regulatory and Security Regulatory Special Revenue Funds to the General Fund at the end of fiscal years 1986-87 and 1987-88. General Fund Transfers In and Special Revenue Funds Transfers Out are understated by \$116,820 at fiscal year-end 1986-87 and \$375,336 at fiscal year-end 1987-88. By the end of fiscal year 1987-88, total cash balance of \$492,156 in the insurance and securities regulatory accounts had not been transferred to the General Fund.

Sections 17-2-121(3) and 30-10-115(3), MCA, require any cash balance remaining in the insurance and securities regulatory trust accounts be transferred to the General Fund after all current fiscal year expenditures are met. Rather than transferring all the remaining cash, the Office only transferred the amount of the transfer appropriation. The Office should monitor its budget authority to ensure adequate authority exists to make the total transfer and obtain a budget amendment increasing the appropriation authority to allow transfer of the year-end cash balances, in compliance with state law. Personnel at the Office of Budget and Program Planning indicated that the transfer appropriation was an administrative appropriation and it would not be a problem to increase budget authority to facilitate the total cash transfer.

RECOMMENDATION #3

We recommend the State Auditor's Office:

- A. Obtain budget authority and transfer \$492,156 to the General Fund.**
- B. Transfer the cash balances remaining in the insurance and securities regulatory trust accounts at each fiscal year-end in accordance with state law.**

Firefighters' Unified Retirement Supplement

During each of the two fiscal years audited, the State Auditor's Office notified the Public Employees' Retirement Division (PERD) that the firemen pension adjustment account had insufficient money to pay the full amount of firefighters unified retirement supplement that PERD requested. PERD requested \$972,053 in fiscal year 1986-87; the Office said the account only had \$953,864. The difference of \$18,189 was paid in the following year. Similarly, PERD requested \$965,237 in fiscal year 1987-88 and Office said the account was short by \$13,426.

We reviewed the firemen's pension adjustment account for both fiscal years and determined there was adequate cash to provide the payments when requested by PERD. The firemen pension adjustment account records the collection of a tax of 1 1/2 percent on the fire portion of insurance premiums. This money is deposited into the state Special Revenue Fund.

An official at the State Auditor's Office said the total payment in fiscal year 1987-88 was not made because insufficient appropriation authority existed to record the total expenditure. Payments out of this account are statutorily appropriated per section 19-11-606, MCA; therefore, the Office should have requested increasing spending authority in order to make the total payment.

RECOMMENDATION #4

We recommend the State Auditor's Office:

- A. Obtain additional budget authority to pay the remaining \$13,426 owed to PERD.**
- B. Establish procedures to ensure sufficient authority exists to distribute the total amount of firefighters' unified retirement supplemental to PERD when due.**

Investment Requirements

Sections 17-2-122 and 30-10-116, MCA, require the State Auditor's Office to invest the money in the insurance and securities regulatory trust accounts with the Board of Investments (BOI). All earnings derived from the investment activity are required to be paid into the regulatory trust accounts.

The money in the accounts was not invested by the Office in accordance with state law. However, the money was invested by the BOI as part of treasury cash. The treasury cash earnings went directly to the General Fund. If the money had been invested for the benefit of the insurance and securities accounts, the earnings would have been transferred to the General Fund at the end of the fiscal year as part of the mandatory cash transfer as discussed on page five. Therefore, in essence there is no effect on the General Fund.

An Office official said it would require additional administrative time to monitor the cash balances in the insurance and securities accounts to determine how much could be available for investments. If Office officials determine it is not cost beneficial to monitor the accounts to comply with state law, they should seek legislation amending the specific investment statutes. Unless the statutes are amended, the Office is required to request the money be invested and the investment earnings be deposited in the insurance and securities regulatory trust accounts.

RECOMMENDATION #5

We recommend the State Auditor's Office either:

- A. Invest the available cash balances in the insurance and securities regulatory trust accounts in accordance with sections 17-2-122 and 30-10-116, MCA; or
- B. Seek legislation amending the statutes which require separate investment of insurance and securities regulatory trust moneys.

Fixed Asset Capitalization

The State Auditor's Office has not recorded fixed asset additions and deletions on the state's property accounting records. State policy in effect during our audit period required equipment with a unit cost of \$200 or more be recorded as fixed assets. Our review of the November 30, 1988, fixed asset register shows January 1985 as being the most recent acquisition date of equipment recorded by the Office. Fiscal year 1985-86 purchases of \$159,332 of computer equipment and a \$10,057, 1986 Chevrolet Caprice are not recorded on the property accounting records. Also a 1977

automobile, which was replaced by the 1986 model noted above, has not been deleted from the accounting records.

We discovered, through discussion with Office personnel, that documents for the computer equipment were prepared and submitted but rejected because they were incorrect. A change in personnel caused the rejected documents to go unnoticed; therefore, they were not resubmitted. Furthermore, due to personnel changes, no one in the Office was aware of the procedures required to update the property accounting records.

We noted that Office personnel have placed state of Montana property tags on purchased equipment, including the computer equipment. In addition, the Office has performed a physical inventory of equipment. However, we noted that some items, such as computer keyboards, were not included on the inventory lists. The Office has not compared its inventory lists to the fixed asset register to see which items are not included on the state's property accounting records.

State policy raised the fixed asset capitalization limit to \$1,000 effective July 1, 1988. However this change in policy does not affect the capitalization of fixed assets purchased prior to July 1, 1988. These assets should be recorded on the property accounting records under the capitalization policy in effect at the time they were purchased. Since no fixed asset have been capitalized since January 1985, the Office should review its equipment purchases since that time and record them in accordance with state policy.

RECOMMENDATION #6

We recommend the State Auditor's Office update the Office's property records to include all existing fixed assets.

ADEQUATE TRAINING NECESSARY

During the audit of the Office, we found that the accounting staff had received training in the state's budgeting and accounting procedures; however, continued training in state accounting procedures is needed to allow them to keep up with policies and procedures affecting the Office. Adequate training is necessary to ensure accounting transactions are processed in accordance with state policy. Also, if the Office had a detailed policy and procedures manual outlining tasks and responsibilities, errors and oversights could be minimized in the event of staff turnover.

RECOMMENDATION #7

We recommend the State Auditor's Office:

- A. Obtain additional training on state accounting policies for its accounting staff.**
- B. Develop a comprehensive policy and procedures manual.**

FEDERAL FOREST RESERVE GRANT

The State Auditor's Office receives federal funds from the U.S. Department of Agriculture, Forest Service. The federal government sends the money to the Office for Montana's share of earnings from national forests located within the state's boundaries. The money received is to be allocated, as directed by the federal government, to counties entitled to a portion of the receipts. The counties use of the funds are limited by section 17-3-213, MCA.

Monitoring System

The Single Audit Act of 1984, implemented by Office of Management and Budget (OMB) Circular A-128, requires a grantee to establish a monitoring system for subrecipients of federal assistance. Thus, the State Auditor's Office is required to have a monitoring system for the counties receiving forest reserve money (CFDA #10.665). In addition, the grant agreement the State Auditor's Office has with the federal government requires the Office to ensure that funds are used for the benefit of public schools and roads, as set forth in state law.

During our previous audit of the State Auditor's Office, we expressed concern that the Office did not have a monitoring system for the counties. The Office responded that it would have a system in place by December 1986. However, we found that the Office still did not have a monitoring system as of December 1988.

The Department of Commerce, Local Government Services has the responsibility for ensuring all counties are audited. The Office receives Local Government Services' audit reports for counties that receive forest reserve money. The audit reports can be used to determine if the counties spent the forest reserve money in accordance with state law and the federal grant agreement. The Office should establish procedures to verify that the audit reports it receives comply with the requirements of OMB Circular A-128 and act on the audit reports containing issues that could affect the counties use of forest reserve money.

RECOMMENDATION #8

We recommend the State Auditor's Office develop a subrecipient monitoring system for federal moneys in accordance with OMB Circular A-128.

Forest Reserve Investment Earnings

The U.S. Department of Agriculture distributes annual federal forest reserve money (CFDA #10.665) in two payments which are received by the State Auditor around October and December of each year. State law requires the State Auditor to direct the distribution of all forest reserve money and interest earned on that money to Montana counties within 30 days after receiving full payment.

The State Auditor's Office received and held the first fiscal 1987-88 payment of \$4,819,230 for 105 days, but invested it for only 48 days. The second 1988 payment of \$1,581,874 was held for 30 days but only invested for 18 days. During the time the forest reserve money was not invested by the State Auditor's Office for the benefit of the fund, it remained in the Treasurer's Fund. Using the Treasurer's Fund investment yield rate for fiscal year 1987-88, we estimate interest earned on forest reserve moneys of \$54,887 was credited to the state General Fund rather than the Federal Forest Reserve Account. Consequently, \$54,887 was not distributed to counties as required by state law. We also reviewed the receipt, investment, and distribution of forest reserve money to counties in fiscal year 1986-87 and estimate \$27,469 of investment earnings accrued to the General Fund rather than being distributed to counties.

The Board of Investments (BOI) invests the money for the Treasurer's Fund. Since investment earnings were credited to the General Fund, the Office should work with BOI to determine the exact amount of earnings that accrued to the General Fund for fiscal year 1986-87 and fiscal year 1987-88. Once the amounts have been determined, the State Auditor's Office should request that BOI transfer the money out of the General Fund and credit it to the Federal Forest Reserve Account so the Office can distribute the interest earnings to the counties in accordance with state law.

RECOMMENDATION #9

We recommend the State Auditor's Office:

- A. Work with BOI to determine the dollar amount of interest earnings that should have been distributed to the counties in fiscal years 1986-87 and 1987-88.
- B. Transfer interest earned on federal forest reserve money to the Federal Forest Reserve Account.
- C. Distribute the interest earned on federal forest reserve money to the counties in accordance with state law.
- D. Invest forest reserve money from the time received until distributed.

COMPUTER CONTROLS AND SAFEGUARDS

During fiscal year 1986-87 the Office installed a minicomputer. Four applications have been developed for use on the system:

- 1. The insurance program maintains information about insurance companies, agencies and agents.
- 2. The securities program maintains information on security offerings, companies selling securities and agents licensed to sell securities.
- 3. The fiscal cash system tracks incoming moneys for insurance and securities deposits.
- 4. The warrant system tracks cancelled warrants.

In addition to these applications, the system is used for word processing and intra-office electronic mail.

Disaster Recovery

Presently the Office does not have a written disaster recovery plan outlining the actions or operations needed to recover daily operations in case of a natural disaster or major equipment breakdown. In addition, the room where the minicomputer is located does not have a smoke detector. The Office should maintain adequate written recovery procedures to ensure a rapid system recovery from a major catastrophe. The purpose of the recovery procedures is to allow normal operations to resume as quickly as possible. Damage to equipment and files needed for the efficient operations of the Office could be minimized in the event of a fire if a smoke detector was installed.

Personnel at the Office stated they do have written initiation procedures for system recovery in the case of short interruptions such as power outages; however, they do not have any written disaster recovery procedures for major system interruptions. The Office's disaster recovery plan should document such things as alternate off-site processing locations and names of key vendor technicians. Personnel estimate the Office could function for two to three days without significantly impairing normal operations in the event of a major system breakdown.

RECOMMENDATION #10

We recommend the State Auditor's Office develop a disaster recovery plan and obtain a smoke detection device.

PRIOR AUDIT RECOMMENDATIONS

The prior audit of the Office was conducted for the two fiscal years ended June 30, 1986. The report contained six recommendations, of which five are still applicable to the Office's operations. The Office concurred with all five recommendations.

We reviewed the status of these prior audit recommendations and determined that the Office implemented four and did not implement one. The recommendation which was not implemented concerned recording expenditure accruals and is again addressed in this report.

INDEPENDENT AUDITOR'S REPORT
AND AGENCY FINANCIAL SCHEDULES

SUMMARY OF AUDITOR'S REPORT

The financial schedules for the State Auditor's Office are prepared from the Statewide Budgeting and Accounting System without adjustments for errors noted during the audit. The auditor's opinion issued in this report is intended to convey to the reader of the financial schedules the degree of reliance which can be placed on the amount presented.

We issued an adverse opinion on the Schedule of Changes in Fund Balances, the Schedule of Budgeted Revenue and Transfers in - Estimate and Actual for the two fiscal years ended June 30, 1988, and the Schedule of Budgeted Program Expenditures and Transfers Out by Object and Fund for the fiscal year ended June 30, 1988. These schedules are misstated by the misclassification of \$38,214,523 and \$24,149,745 of revenue between licenses and permits and taxes for fiscal years 1987-88 and 1986-87, respectively. Also, because expenditure accruals of \$6,565,649 were not recorded in fiscal year 1987-88, the schedules are not fairly stated and the user of these schedules cannot rely on the information presented.

The unqualified opinion on the Schedule of Budgeted Program Expenditures and Transfers Out by Object and Fund for the fiscal year ended June 30, 1987 means the schedule is fairly stated and the user may rely on the information presented.



LEGISLATIVE AUDITOR:
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Performance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying financial schedules for the State Auditor's Office for each of the two fiscal years ended June 30, 1987 and 1988, as shown on pages 16 through 21. The information contained in these schedules is the responsibility of the State Auditor's Office management. Our responsibility is to express an opinion on those financial schedules based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial schedules are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial schedules. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 1, these financial schedules are prepared in accordance with state accounting policy and are not intended to be a presentation in conformity with generally accepted accounting principles.

The State Auditor's Office misclassified the collection of insurance premium taxes as licenses and permits. For the fiscal years ended June 30, 1988 and 1987, respectively, the Schedule of Budgeted Revenue and Transfers In - Estimate and Actual understated General Fund tax revenue by \$31,622,077 and \$17,827,085 and understated Special Revenue Fund tax revenue by \$6,592,446 and \$6,322,660. Licenses and permits revenues are overstated by the same amounts in the General and Special Revenue Funds .

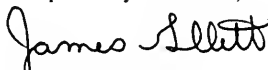
Retirement expenditures of \$5,618,600 in the Local Assistance Distribution Program and \$947,049 in the Pension Adjustment Retired Firemen Program on the

Schedule of Budgeted Program Expenditures and Transfers Out by Object and Fund for the fiscal year ended June 30, 1988 have not been recorded. Fiscal year 1987-88 Budgeted Expenditures in the Special Revenue Fund are understated by \$6,565,649 and the June 30, 1988 Fund Balance in the Special Revenue Fund is overstated by the same amount.

In our opinion, because of the effects of the matters discussed in the two preceding paragraphs, the Schedule of Changes in Fund Balances, the Schedule of Budgeted Revenue and Transfers In - Estimate and Actual for the two fiscal years ended June 30, 1988, and the Schedule of Budgeted Program Expenditures and Transfers Out by Object and Fund for the fiscal year ended June 30, 1988, do not present fairly, in conformity with the basis of accounting described in Note 1, the financial position of the State Auditor's Office.

In our opinion, the Schedule of Budgeted Program Expenditures and Transfers Out by Object and Fund for the fiscal year ended June 30, 1987, presents fairly, in all material respects, the results of operations of the State Auditor's Office in conformity with the basis of accounting described in Note 1.

Respectively submitted,

A handwritten signature in black ink, appearing to read "James Gillett". The signature is fluid and cursive, with the first name "James" being more prominent than the last name "Gillett".

James Gillett, CPA
Deputy Legislative Auditor

December 16, 1988

STATE AUDITOR'S OFFICE
SCHEDULE OF CHANGES IN FUND BALANCES
FOR THE TWO FISCAL YEARS ENDED JUNE 30, 1988

	<u>General Fund</u>	<u>Special Revenue Funds</u>
FUND BALANCE: July 1, 1986	\$ <u>-0-</u>	\$ <u>585,034</u>
ADDITIONS:		
<u>Fiscal Year 1986-87</u>		
Budgeted Revenue & Transfers In	20,142,205	16,726,311
Prior Year Revenue Adjustments	347,695	
Prior Year Expenditure Adjustments	5,737	964
<u>Fiscal Year 1987-88</u>		
Budgeted Revenue & Transfers In	33,821,436	17,068,214
Prior Year Expenditure Adjustments	2,922	
Prior Year Revenue Adjustments		<u>194,404</u>
Total Additions	<u>54,319,995</u>	<u>33,989,893</u>
REDUCTIONS:		
<u>Fiscal Year 1986-87</u>		
Budgeted Expenditures & Transfers Out	1,044,622	16,808,970
Support To State Of Montana	19,451,015	
Prior Year Revenue Adjustments		350,482
<u>Fiscal Year 1987-88</u>		
Budgeted Expenditures & Transfers Out	809,795	10,166,526
Prior Year Revenue Adjustments	194,804	
Support To State Of Montana	32,819,759	
Prior Year Expenditure Adjustments		<u>77,463</u>
Total Reductions	<u>54,319,995</u>	<u>27,403,441</u>
FUND BALANCE: June 30, 1988	\$ <u>-0-</u>	\$ <u>7,171,486</u>

This schedule is prepared from the Statewide Budgeting and Accounting System. Additional information is provided in the notes to the financial schedules on pages 20 through 21.

STATE AUDITOR'S OFFICE
SCHEDULE OF BUDGETED REVENUE & TRANSFERS IN - ESTIMATED & ACTUAL
FOR EACH OF THE TWO FISCAL YEARS ENDED JUNE 30, 1988

	<u>Licenses and Permits</u>	<u>Fines & Forfeits</u>	<u>Income Collections & Transfers</u>	<u>Charges For Services</u>	<u>Investment Earnings</u>	<u>Federal Assistance</u>	<u>Total</u>
<u>Fiscal Year 1987-88</u>							
GENERAL FUND							
Estimated Revenue	\$35,794,000	\$ 6,500	\$2,153,000				\$37,953,500
Actual Revenue	<u>31,622,077</u>	<u>44,359</u>	<u>2,155,000</u>				<u>33,821,436</u> ¹
Collections Over (Under) Estimate	<u>\$(4,171,923)</u>	<u>\$37,859</u>	<u>\$ 2,000</u>				<u>\$(4,132,064)</u>
SPECIAL REVENUE FUND							
Estimated Revenue	\$10,003,000			\$373,358	\$103,000	\$6,800,000	\$17,279,358
Actual Revenue	<u>10,136,759</u>			<u>378,854</u>	<u>52,400</u>	<u>6,500,201</u>	<u>17,068,214</u>
Collections Over (Under) Estimate	<u>\$ 133,759</u>			<u>\$ 5,496</u>	<u>\$(50,600)</u>	<u>\$(299,799)</u>	<u>\$ (211,144)</u>
<u>Fiscal Year 1986-87</u>							
GENERAL FUND							
Estimated Revenue	\$15,550,000	\$10,800	\$2,343,634				\$17,904,434
Actual Revenue	<u>17,827,085</u>	<u>10,120</u>	<u>2,305,000</u>				<u>20,142,205</u>
Collections Over (Under) Estimate	<u>\$ 2,277,085</u>	<u>\$ (680)</u>	<u>\$ (38,634)</u>				<u>\$ 2,237,771</u>
SPECIAL REVENUE FUND							
Estimated Revenue	\$ 9,997,000			\$245,000	\$48,000	\$6,000,000	\$16,290,000
Actual Revenue	<u>9,617,054</u>			<u>241,457</u>	<u>45,241</u>	<u>6,822,559</u>	<u>16,726,311</u>
Collections Over (Under) Estimate	<u>\$ (379,946)</u>			<u>\$ (3,543)</u>	<u>\$(2,759)</u>	<u>\$ 822,559</u>	<u>\$ 436,311</u>

¹ The Office collected more revenue in fiscal year 1987-88 than in fiscal year 1986-87 because the due date for tax on insurance premiums changed from annual to quarterly.

STATE AUDITOR'S OFFICE
SCHEDULE OF BUDGETED PROGRAM EXPENDITURES AND TRANSFERS OUT BY OBJECT AND FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 1988

	State Auditors Office	Audit Division	Insurance	Securities	Local Assistance Distribution	Forest Res & FPGA To Counties	Pension Adj Retired Firemen	Total
PERSONAL SERVICES								
Salaries	\$159,954	\$ 339,813	\$ 449,417	\$ 187,356				\$ 1,136,540
Employee Benefits	35,918	75,610	98,383	38,774				248,685
Total	<u>195,872</u>	<u>415,423</u>	<u>547,800</u>	<u>226,130</u>				<u>1,385,225</u>
OPERATING EXPENSES								
Contracted Services	2,001	419,476	12,479	8,721				442,677
Supplies & Materials	3,623	37,564	21,652	8,311				71,150
Communications	19,308	86,133	74,757	16,071				196,269
Travel	227	1,933	31,241	5,866				39,267
Rent	3,192	29,945	16,890	2,943				52,970
Repair & Maintenance	2,240	16,239	5,451	4,875				28,805
Other Expenses	2,484	1,142	9,408	2,809				15,843
Total	<u>33,075</u>	<u>592,432</u>	<u>171,878</u>	<u>49,596</u>				<u>846,981</u>
EQUIPMENT AND INTANGIBLE ASSETS								
Equipment	495	5,234	7,143	5,453				18,325
Total	<u>495</u>	<u>5,234</u>	<u>7,143</u>	<u>5,453</u>				<u>18,325</u>
LOCAL ASSISTANCE								
From Federal Sources						\$6,552,601		6,552,601
From Other Income Sources							\$ 18,189	18,189
Total						<u>6,552,601</u>	<u>18,189</u>	<u>6,570,790</u>
TRANSFERS								
Mandatory Transfers			425,000	1,730,000				2,155,000
Total			<u>425,000</u>	<u>1,730,000</u>				<u>2,155,000</u>
TOTAL PROGRAM EXPENDITURES	<u>\$229,442</u>	<u>\$1,013,089</u>	<u>\$1,151,821</u>	<u>\$2,011,179</u>	<u>-0-</u>	<u>\$6,552,601</u>	<u>\$ 18,189</u>	<u>\$10,976,321</u>
GENERAL FUND								
Budgeted	\$241,103	\$ 787,299						\$ 1,028,402
Actual	229,442	580,353						809,795
Unspent Budget Authority	<u>\$ 11,661</u>	<u>\$ 206,946</u>						<u>\$ 218,607</u>
SPECIAL REVENUE FUND								
Budgeted		\$ 441,174	\$1,264,182	\$2,016,594	\$5,800,000	\$6,800,000	\$970,000	\$17,291,950
Actual		432,736	1,151,821	2,011,179		6,552,601	18,189	10,166,526
Unspent Budget Authority		<u>\$ 8,438</u>	<u>\$ 112,361</u>	<u>\$ 5,415</u>	<u>\$5,800,000</u>	<u>\$ 247,399</u>	<u>\$951,811</u>	<u>\$ 7,125,424</u>

STATE AUDITOR'S OFFICE
SCHEDULE OF BUDGETED PROGRAM EXPENDITURES AND TRANSFERS OUT BY OBJECT AND FUND
FOR THE FISCAL YEAR ENDED JUNE 30, 1987

	State Auditors Office	Audit Division	Insurance	Securities	Local Assistance Distribution	Forest Res & FPGA To Counties	Pension Adj Retired Firemen	Total
PERSONAL SERVICES								
Salaries	\$168,304	\$ 320,420	\$ 441,304	\$ 177,083				\$ 1,107,111
Employee Benefits	36,919	72,264	95,269	36,948				241,400
Total	<u>205,223</u>	<u>392,684</u>	<u>536,573</u>	<u>214,031</u>				<u>1,348,511</u>
OPERATING EXPENSES								
Contracted Services	12,548	439,325	26,094	6,176				484,143
Supplies & Materials	2,620	28,090	6,003	5,223				41,936
Communications	22,715	90,356	62,569	11,435				187,075
Travel	555	1,411	15,043	4,740				21,749
Rent	3,252	32,838	16,344	2,478				54,912
Repair & Maintenance	727	15,438	3,695	4,398				24,258
Other Expenses	2,240	1,369	3,631	1,269				8,509
Total	<u>44,657</u>	<u>608,827</u>	<u>133,379</u>	<u>35,719</u>				<u>822,582</u>
EQUIPMENT AND INTANGIBLE ASSETS								
Equipment	101,009	15,415	12,796	580				129,800
Total	<u>101,009</u>	<u>15,415</u>	<u>12,796</u>	<u>580</u>				<u>129,800</u>
LOCAL ASSISTANCE								
From Federal Sources						6,868,219		6,868,219
From Other Income Sources					5,425,616		953,864	6,379,480
Total					<u>5,425,616</u>	<u>6,868,219</u>	<u>953,864</u>	<u>13,247,699</u>
TRANSFERS								
Mandatory Transfers			418,000	1,887,000				2,305,000
Total			<u>418,000</u>	<u>1,887,000</u>				<u>2,305,000</u>
TOTAL PROGRAM EXPENDITURES	<u>\$350,889</u>	<u>\$1,016,926</u>	<u>\$1,100,748</u>	<u>\$2,137,330</u>	<u>\$5,425,616</u>	<u>\$6,868,219</u>	<u>\$953,864</u>	<u>\$17,853,592</u>
GENERAL FUND								
Budgeted	\$352,584	\$ 697,591						\$ 1,050,175
Actual	<u>350,889</u>	<u>693,733</u>						<u>1,044,622</u>
Unspent Budget Authority	<u>\$ 1,695</u>	<u>\$ 3,858</u>						<u>\$ 5,553</u>
SPECIAL REVENUE FUND								
Budgeted		\$ 323,193	\$1,123,923	\$2,138,247	\$5,425,616	\$6,868,219	\$983,864	\$16,863,062
Actual		<u>323,193</u>	<u>1,100,748</u>	<u>2,137,330</u>	<u>5,425,616</u>	<u>6,868,219</u>	<u>953,864</u>	<u>16,808,970</u>
Unspent Budget Authority		<u>\$ 0</u>	<u>\$ 23,175</u>	<u>\$ 917</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 30,000</u>	<u>\$ 54,092</u>

STATE AUDITOR'S OFFICE
NOTES TO THE FINANCIAL SCHEDULES
FOR THE TWO FISCAL YEARS ENDING JUNE 30, 1988

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Accounting

The state of Montana uses the modified accrual basis of accounting which is described in the Montana Operations Manual. Under the modified accrual basis of accounting, a valid obligations exists when the related liability is incurred except for the following items which are also considered valid obligations under state accounting policy.

- If the appropriation provided funds to complete a given project, the entire amount of a service contract may be accrued even though the services are rendered in fiscal years subsequent to the fiscal year in which the expenditure is accrued.
- The anticipated cost of equipment is expensed in the fiscal year in which the purchase order was issued.
- Goods ordered, but not received as of the fiscal year-end, may be accrued if the purchase order was issued in the fiscal year in which the anticipated expenditure is to be accrued.

Revenues under the modified accrual basis of accounting are recognized when measurable and available. "Available" means the revenue will be received soon enough to pay the liabilities of the current period.

Basis of Presentation

The financial schedules were prepared from the Statewide Budgeting and Accounting System (SBAS) without adjustments. Accounts are organized on the basis of funds according to state law. The following fund types are used by the Office:

General - accounts for all financial resources except those required to be accounted for in another fund.

Special Revenue - accounts for the proceeds of specific revenue sources that are legally restricted to expenditures for specific purposes. Legislative appropriation is required to spend from this fund.

Agency - accounts for assets held by a governmental unit in a trustee capacity, or as an agent, for individuals, private organizations, other governmental units, and/or other funds.

2. EMPLOYEES' RETIREMENT SYSTEM

The Office of the State Auditor employees are covered by the Public Employees' Retirement System (PERS). The Office's contribution to PERS for each of the fiscal years ended June 30, 1987, and June 30, 1988, was approximately \$70,217 and \$71,958, respectively.

3. GENERAL FUND BALANCE

The General Fund is a statewide fund. Agencies do not have a separate General Fund since their only authority is to pay obligations from the statewide General Fund as long as they stay within their appropriation limits. Thus, on an agency schedule the General Fund beginning and ending fund balance will always be zero.

4. AGENCY FUNDS

The Office has five Agency Funds recorded on its accounting records at fiscal year-end 1987-88.

Uncleared collection - used to account for cash collected by the Office until properly distributed to the correct fund on SBAS.

Central Payroll - used to account for cash held by the State Auditor to pay warrants issued more than one year ago but not yet returned.

General warrant clearing - used to account for cash held to pay outstanding warrants issued but not yet returned.

Auditor Assignment - used to account for money withheld from warrants by the State Auditor at the request of others (e.g., garnishment of wages).

5. LEAVE LIABILITY

Employees at the State Auditor's Office accumulate both annual and sick leave. Nonexempt employees accumulate compensatory leave. Employees are paid for 100 percent of unused annual, 25 percent of unused sick leave, and 100 percent of unused, nonexempt compensatory leave credits upon termination. At June 30, 1988, the Office had a liability of \$70,202 for annual leave, \$22,705 for sick leave, and \$118 for nonexempt compensatory leave.

AGENCY RESPONSE

STATE AUDITOR
STATE OF MONTANA

RECEIVED

MAR 31 1989

Montana Legislative Auditor



Andrea "Andy" Bennett
STATE AUDITOR

COMMISSIONER OF INSURANCE
COMMISSIONER OF SECURITIES

March 31, 1989

Scott A. Seacat
Legislative Auditor
Room 135, State Capitol
Helena, MT 59620

Dear Mr. Seacat:

Enclosed please find the State Auditor's responses to the recommendations in the Financial-Compliance Audit for the Two Fiscal Years Ended June 30, 1988. I concur with all the recommendations and will take the appropriate steps to implement them.

I wish to thank you and your auditors for the professional manner in which the audit was conducted. I look forward to working with you in the future.

With best personal regards, I am

Very truly yours,

A handwritten signature in cursive script that reads "Andrea 'Andy' Bennett".

Andrea "Andy" Bennett
State Auditor

AB/tle(287)

Recommendation #1

We recommend the State Auditor's Office ensure all revenue is properly classified on its accounting records.

We concur. The particular revenue classification in question was approved by the Accounting Division in August of 1985. The classification title used was Insurance Licenses and Tax. The appropriate paperwork has been submitted and approved by the Accounting Division to correctly classify our premium tax as tax revenue. Our other revenue classifications have been reviewed and found to be correct.

Recommendation #2

We recommend the State Auditor's Office implement procedures to record year-end transactions on a timely basis, and in accordance with state policy.

We concur. These two particular errors were errors of omission and not intentional. A year-end procedure manual will be developed before June 1, 1989 to insure this does not occur again.

Recommendation #3

We recommend the State Auditor's Office:

- A. Obtain budget authority and transfer \$492,156 to the General Fund.
- B. Transfer the cash balances remaining in the insurance and securities regulatory trust accounts at each fiscal year-end in accordance with state law.

We concur. The paperwork to obtain the authority to revert the cash balances has been submitted and approved by the Budget Office. As soon as the cash balances in the accounts are sufficient the reversions will be made. A procedure to accomplish this in a timely manner has been worked out with the Budget Office. This procedure will also be included in the year-end procedure manual.

Recommendation #4

We recommend the State Auditor's Office:

- A. Obtain additional budget authority to pay the remaining \$13,426 owed to PERD.
- B. Establish procedures to ensure sufficient authority exists to distribute the total amount of firefighters' unified retirement supplemental to PERD when due.

We concur. The appropriate paperwork to receive the additional budget authority has been submitted and approved. The payment to PERD will be made before April 1, 1989. This process will also be included in the year-end procedure manual, so that this situation will not occur again.

Recommendation #5

We recommend the State Auditor's Office either:

- A. Invest the available cash balances in the insurance and securities regulatory trust accounts in accordance with sections 17-2-122 and 30-10-116, MCA; or
- B. Seek legislation amending the statutes which require separate investment of insurance and securities regulatory trust moneys.

We concur. We will attempt to comply with the current statutes. If the cost benefit is not sufficient we will attempt to amend the applicable statutes.

Recommendation #6

We recommend the State Auditor's Office update the Office's property records to include all existing fixed assets.

We concur. The PAMS documents to record the computer equipment have been corrected, resubmitted, and approved. We have compared our inventory and the PAMS inventory and are in the process of cleaning up the discrepancies. We are in the process of reviewing all purchases since 1985 and should have that project completed by April 1, 1989. By June 30, 1989 our PAMS inventory will be completely accurate.

Recommendation #7

We recommend the State Auditor's Office:

- A. Obtain additional training on state accounting policies for its accounting staff.
- B. Develop a comprehensive policy and procedures manual.

We concur. Our office has consistently asked for additional training funds from the legislature, but because our office budget has historically not included training funds we have not been successful. Again this session we requested additional training funds and were once again turned down. We will do as much training as our budget allows. We would appreciate any assistance the Legislative Auditor's Office could lend us in obtaining a sufficient training budget.

Recommendation #8

We recommend the State Auditor's Office develop a subrecipient monitoring system for federal moneys in accordance with OMB Circular A-128.

We concur. We have entered into an agreement with the Local Government Services Bureau of the Department of Commerce to receive a copy of all audit reports from the counties. Our Office will then review these audit reports and upon discovery of adverse audit findings, the State Auditor's Office will follow-up on recommendations made by the auditors, or use any other procedure that may be necessary under the circumstances.

Recommendation #9

We recommend the State Auditor's Office:

- A. Work with BOI to determine the dollar amount of interest earnings that should have been distributed to the counties in fiscal years 1986-87 and 1987-88.
- B. Transfer interest earned on federal forest reserve money to the Federal Forest Reserve Account.
- C. Distribute the interest earned on federal forest reserve money to the counties in accordance with state law.
- D. Invest forest reserve money from the time received until distributed.

We concur. We will work with the Board of Investments and make certain the interest that belongs to the Federal Forest Reserve Account is transferred back to it. We will then distribute this money to the counties in the next cycle of payments in December of 1989. This money was invested and distributed appropriately in fiscal year 1988-89.

Recommendation #10

We recommend the State Auditor's Office develop a disaster recovery plan and obtain a smoke detection device.

We concur. While we do not have formal written procedures for disaster recovery, we do have informal arrangements with two other state agencies that have similar equipment. In the past we have borrowed equipment from them and they have borrowed equipment from us. We simply need to formalize these arrangements and put them in writing. We will also work with the Department of Administration's Information Services Division as you suggested. By July 1, 1989 we will have a written disaster recovery plan. We installed a smoke detection device in our computer room on March 27, 1989.

